

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-10 NSAE-00 ICA-11 XMB-02 OPIC-03 SP-02
LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07 CEA-01
H-01 L-03 PA-01 /106 W
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R 271535Z JUN 78
FM AMEMBASSY ROME
TO SECSTATE WASHDC 3843
TREASURY DEPT WASH DC
INFO AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY TOKYO

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USEC; USOECD

E.O. 11652: N/A
TAGS: EFIN, ECON, IT
SUBJECT: OPTIMISTIC FORECAST OF ITALIAN ECONOMY FOR 1978-80
LEADS TO PROPOSAL TO REVALUE LIRA

1. SUMMARY. THE LATEST FORECAST OF THE ITALIAN
ECONOMY FOR THE PERIOD 1978-80 PREPARED BY PROMETEIA,
A FORECASTING GROUP ASSOCIATED WITH THE
UNIVERSITY OF BOLOGNA, PREDICTS A RELATIVELY OPTIMISTIC
PICTURE FOR THE NEXT TWO YEARS. IT SHOWS THE GROWTH
RATE PICKING UP BETWEEN 1979 AND 1980, INFLATION DROPPING
TO BELOW THE DOUBLE-DIGIT LEVEL IN 1980 AND THE CURRENT
ACCOUNT OF THE BALANCE OF PAYMENTS REMAINING IN A HEALTHY
SURPLUS THROUGHOUT THE PERIOD. THE ONE NEGATIVE ASPECT
OF THE FORECAST IS THAT IT SHOWS VERY LITTLE INCREASE
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IN EMPLOYMENT. THE STRONG PERFORMANCE PROJECTED FOR
THE CURRENT ACCOUNT LEADS SENATOR ANDREATTA TO CALL FOR
A FIVE PERCENT REVALUATION OF THE LIRA. END SUMMARY.

2. THE MAJOR COMPONENTS OF THE FORECAST ARE AS
FOLLOWS:

1978 1979 1980

(ANNUAL GROWTH RATES)

GDP 3.2 2.2 4.0

PRIVATE CONSUMPTION 3.7 2.4 4.0
(FAMILIES)

PUBLIC CONSUMPTION 1.9 1.9 1.9

INVESTMENTS:

MACHINERY & EQUIP -0.3 5.5 7.0

CONSTRUCTION 0.4 2.7 1.8

EXPORTS G&S (GDP
BASIS) 5.4 6.2 7.9IMPORTS G&S (GDP
BASIS) 3.6 6.1 8.6INFLATION (COST OF-
LIVING) 12.0 10.9 9.9EMPLOYMENT IN
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INDUSTRY -0.5 0.4 0.5

BALANCE OF PAYMENTS
(BILLIONS OF LIRE)

EXPORTS (FOB) 45,980 53,122 61,408

IMPORTS (FOB) 44,924 51,664 59,924

TRADE BALANCE 1,056 1,458 1,484

CURRENT ACCOUNT BAL. 2,988 2,843 2,335

3. NEEDLESS TO SAY, A FORECAST IS AS GOOD AS ITS ASSUMPTIONS AND ONE MAY DIFFER WITH SOME OF PROMETEIA'S MORE SIGNIFICANT ASSUMPTINS. ON THE PUBLIC SECTOR DEFICIT (ENLARGED), THE FORECAST ASSUMES THAT, IN RELATION TO GDP, IT WILL STAY VIRTUALLY CONSTANT DURING THE PERIOD. IT FURTHER ASSUMES THAT THE FINANCING OF SUCH DEFICITS WILL NOT BE INFLATIONARY. INTEREST RATES, WHICH ARE EXOGENOUS TO THE MODEL, ARE IN FACT ASSUMED TO REMAIN UNCHANGED DURING 1978-80. ON THIS SCORE,

PROMETEIA IS MORE OPTIMISTIC THAN THE GOVERNMENT'S OWN ESTIMATES. FOR 1978, IT ESTIMATES A DEFICIT OF 29,878 BILLION LIRE, ON THE BASIS OF CURRENT BUDGET LEGISLATION, WHEREAS THE GOVERNMENT'S ESTIMATE IS 34,376 BILLION LIRE. THE DIFFERENCE BETWEEN THE TWO FIGURES IS FOUND ON THE EXPENDITURE SIDE. PROMETEIA DOES NOT BELIEVE THAT THE GOVERNMENT CAN SPEND AS MUCH MONEY AS HAS BEEN LEGISLATED AND THEREFORE CARRIES A LOWER EXPENDITURE TOTAL FOR 1978. ANOTHER ASSUMPTION WHICH RAISES QUESTIONS IS THE EXCHANGE RATE, ALSO EXOGENOUS TO THE MODEL, FOR THE YEARS 1979 AND 1980. PROMETEIA IS ASSUMING A STABLE EXCHANGE RATE FOR THESE TWO YEARS, PRECEDED BY AN APPRECIATION OF 1.5 PERCENT IN 1978.

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4. SENATOR ANDREATTA, THE INTELLECTUAL FATHER OF PROMETEIA, HAS USED PROMETEIA'S LATEST FORECAST OF THE ITALIAN ECONOMY AS THE BASIS FOR A PROPOSAL CALLING FOR AN IMMEDIATE 5 PERCENT REVALUATION OF THE LIRA VIS-A-VIS THE DOLLAR. SPEAKING TO THE MEMBERS OF PROMETEIA IN BOLOGNA ON JUNE 23, A SESSION ATTENDED BY TREASATT, ANDREATTA ARGUED THAT, GIVEN THE CONTINUED SIZEABLE CURRENT ACCOUNT SURPLUS PROJECTED BY THE MODEL THROUGH 1980, EXCHANGE RATE POLICY SHOULD BE USED MORE AS AN INSTRUMENT TO CONTAIN INFLATION AND LESS AS A MEANS OF INCREASING RESERVES AND MAINTAINING COMPETITIVENESS. HE MAINTAINED THAT THE BANK OF ITALY HAS ACCUMULATED ENOUGH RESERVES TO (A) MEET ITS FOREIGN OBLIGATIONS AND (B) ACT AS A BUFFER AGAINST FORESEEABLE PRESSURES ON THE LIRA. FURTHER MARKET INTERVENTIONS (READ DOLLAR PURCHASES), HE LIMITED OFFICIAL USE

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ASSERTED, TO KEEP A STABLE LIRA/DOLLAR RATE DOES NOT MAKE SENSE. TO MAINTAIN COMPETITIVENESS, HE RECOMMENDED THAT POLICIES BE FOCUSED ON THE "REAL" VARIABLES, SUCH AS THE DYNAMICS OF RELATIVE COSTS OF PRODUCTION. IN THIS REGARD, HE SUGGESTED THAT THE GOVERNMENT PROPOSE A FREEZE ON THE SCALA MOBILE FOR ONE YEAR, IN EXCHANGE FOR A FLAT 30,000 LIRE INCREASE IN WAGES ACROSS-THE-BOARD FOR 1979. BOTH THE LIRA REVALUATION AND THE FREEZING OF THE SCALA MOBILE WOULD REDUCE INFLATIONARY EXPECTATIONS. AS A RESULT, IN 1979 THE RATE OF INFLATION WOULD BE APPROXIMATELY 3 PERCENTAGE POINTS LOWER THAN THE ONE NOW FORECAST (7.9 VS. 10.9), WITH INTEREST RATES MOVING DOWNWARD PARI PASSU. SINCE PUBLIC EXPENDITURES ARE (A) HIGHLY INDEXED AND (B) HEAVILY BURDENED WITH DEBT SERVICING, LOWER INFLATION AND INTEREST RATES WOULD REDUCE PUBLIC EXPENDITURES BY 3,500 BILLION LIRE IN 1979-80. HE SUGGESTED THAT THESE "SAVINGS" BE SPENT BY THE GOVERNMENT ON PUBLIC SECTOR INVESTMENTS WITH TWO POSITIVE RESULTS: (A) TO OFFSET THE EXPECTED FALL IN DEMAND DUE TO DECREASED EXPORTS AND (B) TO ACHIEVE THE DESIRABLE OBJECTIVE OF SHIFTING RESOURCES OUT OF CONSUMPTION INTO INVESTMENTS.

6. ANDREATTA'S PROPOSAL WAS NOT WIDELY SUPPORTED BY THOSE ATTENDING THE CONFERENCE AND HAS ALREADY BEEN REJECTED BY THE UNIONS WHICH LEARNED ABOUT IT FROM LEAKS TO THE PRESS. MANY OF THE PARTICIPANTS DISAGREED THAT ITALY HAS ACCUMULATED SUFFICIENT RESERVES AND THAT ITALY'S COMPETITIVE POSITION PERMITTED A REVALUATION. OTHERS WONDERED WHETHER AN ANNOUNCEMENT BY THE BANK OF ITALY THAT IT WAS SUSPENDING ITS INTERVENTION IN THE MARKET WOULD IN FACT LEAD TO A REVALUATION OVER THE LONGER TERM. WOULD NOT MUCH DEPEND ALSO ON WHAT HAPPENS TO THE

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DOLLAR? IF THE RECEPTION GIVEN TO ANDREATTA'S PROPOSAL
AT THE MEETING IS REPRESENTATIVE OF INFORMED OPINION
IN ITALY, IT WILL PROBABLY NOT GET VERY FAR.GARDNER

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